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Supreme Court of the United States

October Term, 1954

No. 714

DICTOGRAPH PRODUCTS, INC.,
Petitioner,

against

FEDERAL TRADE COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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49

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TABLE OF CONTENTS

PAGE

APPENDIX:

Opinion of Court of Appeals 1a

Opinion of Commission 16a

Cases Cited

B. S. Pearsall Butter Co. v. Federal Trade Commission, 292 Fed. 720 5

Carlay Co. v. Federal Trade Commission, 153 F. (2d) 493 7

Gelb v. Federal Trade Commission, 153 F. (2d) 493 7

International Business Machines Corp. v. U. S., 298 U. S 131 11

International Salt Co., Inc. v. U. S., 332 U. S. 392 .. 11

J. B. Lippincott Co. v. Federal Trade Commission, 137 F. (2d) 490 7

Maico Co. Inc. (Commission's Docket No. 5822) 8, 9, 10

Minneapolis-Honeywell Company v. Federal Trade Commission, 191 F. (2d) 786 5

Oxford Varnish Corporation v. Ault & Wiborg Corp., 83 F. (2d) 764 11

Pennsylvania R. Co. v. Interstate Commerce Commission, 66 F. (2d) 37, aff'd 291 U. S. 651 5

Pick Manufacturing Co. v. General Motors, 80 F. (2d) 641, aff'd 299 U. S. 3 .....5, 6, 11

Standard Oil Company v. U. S. 337 U. S. 293 ..... 6, 7, 8

United States v. Columbia Steel, 334 U. S. 495 8

Statutes Cited

	PAGE
15 U. S. C. Sect. 14 (Section 3 of the Clayton Act)	2, 3, 5, 6, 11
15 U. S. C. Sect. 21	1, 7
15 U. S. C. Sec. 45(a) (Section 5 of the Federal Trade Commission Act)	2, 3
15 U. S. C. Sect. 45(c)	1, 7
28 U S. C. Sect. 1254	1

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No.

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FEDERAL TRADE COMMISSION,
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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The above named petitioner respectfully prays that a writ of certiorari issue to review the order entered in this case on January 10, 1955, by the United States Court of Appeals for the Second Circuit, which affirmed an order of the Federal Trade Commission. A petition for rehearing was denied by the Court of Appeals on January 10, 1955.

The Federal Trade Commission rendered an opinion in issuing its order. The opinion of the Court of Appeals is reported at 217 F. (2d) 821. Copies of both opinions are appended.

Jurisdiction is conferred upon the Supreme Court to review the order of the Court of Appeals by writ of certiorari by 15 U. S. C., Sect. 45(c), 15 U. S. C., Sect. 21, and 28 U. S. C., Sect. 1254.

The proceeding in the Court of Appeals was on a petition to review an order of the Federal Trade Commission

which directed petitioner to eliminate from its contracts with its distributors (actually retail sellers) of hearing aids a covenant prohibiting the sale of competing makes of hearing aids and to cease and desist from certain practices in connection therewith in alleged violation of Section 3 of the Clayton Act (15 U. S. C., Sec. 14) and Section 5 of the Federal Trade Commission Act (15 U. S. C., Sec. 45 (a)).

Section 3 of the Clayton Act, insofar as it is applicable, provides:

> "That it shall be unlawful for any person engaged in commerce, in the course of such commerce, to * * * make a sale or contract for sale of goods, wares, merchandise * * * for * * * resale * * *, on the condition, agreement, or understanding that the * * * purchaser thereof shall not use or deal in the goods, wares, merchandise * * * of a competitor or competitors of the * * * seller, where the effect of such * * * sale, or contract for sale or such condition, agreement or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce."

Section 5 of the Federal Trade Commission Act, insofar as it is applicable, provides:

> "Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are hereby declared unlawful.
>
> "The Commission is hereby empowered and directed to prevent persons, partnerships or corporations * * * from using unfair methods of competition in commerce and unfair or deceptive acts or practices in commerce."

The complaint was issued by the Federal Trade Commission on May 2, 1949. Hearings were held before a trial

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examiner in various cities of the United States between December 19, 1949 and May 9, 1952. The hearing examiner's initial decision was made on November 10, 1952. The Commission's order was issued September 24, 1953.

Petitioner manufactures hearing aids under its trade name "Acousticon". Its method of distribution from about 1939 until issuance of the complaint was, except for a few branches in major cities, through distributors who were appointed by written contracts under which they obtained exclusive territories and were permitted to and did use the name "Acousticon" as part of the name under which they did business, such as "Acousticon Smith Company" or "Acousticon of Boston".

Admittedly, the various contracts employed by petitioner during the complaint period contained a provision prohibiting the distributors from selling competing makes of hearing aids. The sole issue presented by the complaint was that such exclusive dealing provision and its enforcement violated Section 3 of the Clayton Act and Section 5 of the Federal Trade Commission Act.

Petitioner's defenses were chiefly along three lines:

(a) That since competition increased tremendously, despite petitioner's exclusive dealing provision and during its use by petitioner, no violation of Section 3 of the Clayton Act was committed, because obviously when competition increases tremendously the covenant could not possibly be deemed to tend to lessen or lessen competition.

(b) That in response to findings and recommendations emanating from a survey and clinical investigation of hearing conducted by the United States Public Health Service petitioner embarked upon a long range program of research and development, and established that different causes of deafness produced varying types as well as degrees of hearing impairment, and developed and manufactured a variety of hearing aid receivers essential to

properly correct different types of hearing losses, and developed and employed unique fitting procedures, speech tests and speech testing equipment—all of which were not done or provided by any other manufacturer; and that, therefore, the exclusive dealing provision was necessary for the protection of petitioner's good will.

(c) That the covenant protected valuable trade secrets given by petitioner to its distributors and was a valid obligation voluntarily contracted by the distributor in consideration of the exclusive territory assigned to him, his operation of his business under petitioner's trade name "Acousticon", and valuable sales, advertising, training and other commercial benefits given to him by petitioner.

Petitioner's defenses were overruled by the Federal Trade Commission and the Court of Appeals.

It is respectfully submitted that the following constitute proper and substantial reasons for granting this petition:

1. Since competition increased tremendously, the holding that the effect of petitioner's exclusive dealing provision "* * * may be to substantially lessen competition" (to use the wording of the statute) was baseless.

The undisputed evidence clearly established that, despite petitioner's exclusive dealing covenant and during its use, the number of firms manufacturing hearing aids increased from about twenty to over eighty; that a substantial number of new hearing aid manufacturers came into the business, established themselves as factors in the industry, and built up distributor organizations; that competition increased tremendously; and that competition among the various manufacturers and distributors was extremely active, intense and keen.

Until the decision of the Court of Appeals herein, it was an established rule of law that, where competition

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substantially increased throughout the period of use of an exclusive dealing provision, Section 3 of the Clayton Act was not violated, since obviously use of the exclusive dealing provision did not have nor could have any effect, probable or otherwise, upon competition.

This rule was established in the case of *Pick Manufacturing Co.* v. *General Motors,* 80 F. (2d) 641, affirmed 299 U. S. 3, where the Court specifically stated, at page 644 of 80 F. (2d):

> "* * * the record shows that competition in the sale of replacement parts for automobiles instead of growing less has substantially increased through the period during which the provisions complained of have been in force and, while it may be that competition would have increased more rapidly in the absence of such provisions, the trial court rightfully concluded that such was not the substantial lessening of competition which the Clayton Act was designed to prevent * * *".

This rule of law has been consistently applied by the courts:

Pennsylvania R. Co. v. *Interstate Commerce Commission,* 66 F. (2d) 37, 39, affirmed 291 U. S. 651;
B. S. Pearsall Butter Co. v. *Federal Trade Commission,* 292 Fed. 720, 722;
Minneapolis-Honeywell Company v. *Federal Trade Commission,* 191 F. (2d) 786, 790, 791.

Without even discussing this rule, the Court of Appeals states (Appendix, 12a) that the *Pick* case is troublesome. However, the Court was able to avoid the ruling of the *Pick* case by concluding that the reasoning of the Court of Appeals in the *Pick* case was not approved by the *per curiam* affirmance by the Supreme Court and stat-

ing (obviously uncertain as to its illogical reasoning) that in any event the reasoning in the *Pick* case is quite at variance with that of the Supreme Court in *Standard Oil Company* v. *U. S.*, 337 U. S. 293. In fact, the Court of Appeals states (Appendix, 6a) that the decision of the Supreme Court in the *Standard Oil* case in effect disposes of petitioner's defenses.

However, the clear and logical rule established by the *Pick* case was not overruled by anything stated in the *Standard Oil* case. In the only part of the decision of the *Standard Oil* case where effect upon competition activity was discussed, it is stated, at page 309 of 337 U. S.:

> "* * * In view of the widespread adoption of such (exclusive dealing) contracts by Standard's competitors and the availability of alternate ways of obtaining an assured market, evidence that competitive activity has not actually declined is inconclusive."

Nothing in this language appears to be contrary to the rule in the *Pick* case. It is, therefore, apparent that the determination of the Court of Appeals herein is in direct conflict with the rule of law established by the *Pick* case and raises a substantial federal question.

2. The Court of Appeals held that all that had to be established to prove violation of Section 3 of the Clayton Act was that petitioner enjoyed a substantial share of the market involved, and upheld the Commission's determination that this was established by evidence of petitioner's dollar volume and by a guess of a prejudiced witness for the Commission to the effect that there were approximately 1,000 distributors specializing in the sale of hearing aids, approximately 220 of which concededly represented petitioner exclusively.

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This amounts to a virtual holding by the Court of Appeals of "*per se*" violation of the Clayton Act, and presents an important federal question which should be decided by this Court.

Furthermore, even if we were to assume *arguendo* the correctness of the Court of Appeals' interpretation of the *Standard Oil* case, there was no basis whatever for the findings of substantiality of petitioner's business above referred to.

Findings of the Federal Trade Commission are conclusive as to facts only if supported by testimony (15 U. S. C. 21 and 15 U. S. C. 45(c)). It has been consistently held that findings of the Commission must be based upon substantial evidence.

J. B. Lippincott Co. v. *Federal Trade Commission*, 137 F. (2d) 490, 491;
Gelb v. *Federal Trade Commission*, 144 F. (2d) 580, 582;
Carlay Co. v. *Federal Trade Commission*, 153 F. (2d) 493, 496.

The affirmance by the Court of Appeals of the Commission's order was a complete departure from the law in this respect because:

(a) The holding that petitioner's dollar volume was substantial was not based upon any comparison of petitioner's dollar volume with the dollar volume in the entire industry. No evidence whatever was submitted on behalf of the Commission showing the extent of the dollar volume of the entire hearing aid industry. How could petitioner's dollar volume possibly have been called substantial when the total dollar volume of the industry was unknown? Lacking such basis for comparison, the finding of substantial volume was baseless.

As the Court stated in *United States* v. *Columbia Steel*, 334 U. S. 495, 527:

> "In determining what constitutes unreasonable restraint, we do not think the dollar volume is in itself of compelling significance. We look rather to the percentage of business controlled, the strength of the remaining competition, * * *"

(b) The testimony of the Commission's witness that there were approximately 1,000 representative dealers selling hearing aids in the United States was called a "guess" by the witness, a person who was not qualified to make even such a guess, since he was not engaged in the line of commerce involved, the manufacture and sale of portable hearing aids, and who, at the time of his testimony, had a suit pending against petitioner for treble damages for alleged infringement. To show how baseless this guess was, petitioner established that only 8 or 9 of the approximately 80 or 90 manufacturers of hearing aids had over 1,200 distributors specializing in the sale of hearing aids, and that this figure of over 1,200 did not include the thousands of drug store and optical store outlets used by some manufacturers.

3. The Commission's position herein is entirely inconsistent with its decision in a similar case (*Maico Co., Inc.*, Commission's Docket No. 5822). Here the Commission argued successfully before the Court of Appeals that no weight should be given to petitioner's proof of the tremendous growth of competition. In the *Maico* case (decided by the Commission since the *Standard Oil* decision of the Supreme Court), the Commission held it was its duty to determine the economic effect of an exclusive dealing provision upon competition and to weigh whatever evidence could be adduced showing that use of the provision had no effect upon competition, because competition increased

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despite the provision or because of other factors. The Commission reversed the order of its hearing examiner, because he rejected evidence showing that competition had increased, that Maico's share of the market had been decreasing, that its dealers constituted a small percentage of the total number of hearing aid dealers in the country, and other matters relative to the effect on competition. In so doing, the Commission specifically stated:

> "These factors, in our opinion, all have a very real bearing on whether there may be, or already has been, a substantial lessening of competition due to respondent's exclusive dealing contracts. * * *"
>
> "The hearing examiner presumed the existence of a lessening of competition, yet excluded evidence which might show facts to the contrary. This exclusion was based on an interpretation of the Supreme Court's decision in the Standard Stations case (Standard Oil Co. of California v. U. S., 337 U. S. 293) to the effect that such evidence as to the economic effect of the challenged contract is immaterial and surplusage."
>
> "* * * The Supreme Court did not require evidence of competitive effect under the circumstances of the Standard Stations case, ruling that there was sufficient to show that competition had been foreclosed in a substantial share of the line of commerce affected. * * *"
>
> "It is significant that at the same time the Court pointed out the Federal Trade Commission was adequately equipped to weigh all the relevant economic factors."
>
> "The need for specialized consideration in matters involving complex economic factors and the intention of Congress that the Federal Trade Com-

mission should give such consideration to these matters has often been recognized by the Supreme Court, * * *"

"A reading of Section 3 of the Clayton Act clearly indicates Congress intended to outlaw only those exclusive dealing agreements which are lessening or which if allowed to continue will probably lessen competition or tend to create a monopoly. We believe the structure of the Federal Trade Commission was specifically designed to make decisions involving this type of complex economic problem. To refuse to exercise our talents as an administrative tribunal in these cases because the courts feel 'ill suited' to weigh all of the relevant factors, would deprive the country of the very services which we were created to furnish."

This certainly presents an anomalous situation which requires correction.

4. Was it a valid defense that the covenant was essential for the protection of the petitioner's good will? The facts in support of the defense were undisputed. However, both the Commission and the Court of Appeals misconstrued the meaning of this defense, in holding that economic merit or excellence of a product is no defense to a Section 3 proceeding. While that is true it is not relevant to the question whether a covenant against competing makes may be used for protection of good will under certain conditions.

When it is considered that petitioner's distributors received exclusive territories and operated their businesses under a trade name which incorporated petitioner's trade name "Acousticon", and that petitioner manufactured and provided what no other manufacturer of hearing aids did—it is respectively submitted that petitioner's defense based on protection of its good will was a valid one.

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In not one case has any Court flatly stated that it is not a defense to a Section 3 proceeding to prove that an exclusive dealing provision is essential for good will.

The *Pick* case (80 F. (2nd) 641, 644) affirmatively indicated that this is a valid defense. In other cases, the Court implied that it was a valid defense by specifically ruling it was not established:

International Business Machines Corp. v. *U. S.* 298 U. S. 131, 139, 140;

International Salt Co., Inc. v. *U. S.*, 332 U. S. 392;

Oxford Varnish Corporation v. *Ault & Wiborg Corp.*, 83 F. (2d) 764, 765.

Wherefore, it is respectfully prayed that this petition for a writ of certiorari be granted.

LOUIS P. HAFFER,
Attorney for Petitioner.

THEODORE F. TONKONOGY,
of Counsel.

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APPENDIX

Opinion of Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 57 October Term, 1954.

Argued October 14 and 15, 1954 Decided December 15, 1954

Docket No. 22927

DICTOGRAPH PRODUCTS, INC.,
Petitioner,

v.

FEDERAL TRADE COMMISSION,
Respondent.

Before CHASE, MEDINA and HARLAN, *Circuit Judges.*

Petition to review an order of Federal Trade Commission. Affirmed.

THEODORE F. TONKONOGY, New York City, for Petitioner.

EARL W. KINTNER, ROBERT B. DAWKINS and ALAN B. HOBBES, Washington, D. C., for Respondent.

MEDINA, *Circuit Judge*:

This is a proceeding to review an order of the Federal Trade Commission directing petitioner to eliminate from

its contracts with independent distributors certain restrictive, exclusive-dealing clauses and to cease and desist from certain practices connected therewith, in alleged violation of Section 3 of the Clayton Act (15 U. S. C., Sec. 14) and Section 5 of the Federal Trade Commission Act (15 U. S. C., Sec. 45(a) (c)).

For many years petitioner and its predecessor company have [207] manufactured and distributed hearing aids under its trade name "Acousticon". Due to the fact that there are said to be from 25,000,000 to 55,000,000 persons in the United States who are hard of hearing and to the rapid development in recent years of electronics and allied areas of scientific knowledge, the industry has had phenomenal growth, especially since 1940 or thereabouts. Since long prior to that date petitioner has been one of the largest manufacturers of hearing aids, although there is nothing in the voluminous record now before us to indicate that petitioner now or at any time had a "dominant" position in the hearing aid business.

In the period 1944-1949 petitioner's sales of hearing aids and of parts and accessories were as follows:

Year	*Hearing Aids*	*Parts & Accessories*
1944	$ 741,874	$257,933
1945	1,041,097	162,100
1946	2,231,570	187,761
1947	1,937,432	269,182
1948	1,763,955	200,757
10 Mos. 1949	1,546,797	142,025

While some makes of hearing aids are sold by at least one mail order house and in department, optical and drug stores over the counter, the best market for the manufacturers of hearing aids is the independently established

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retail distributor, whose business is devoted entirely to the fitting and sale of hearing aids to the hard of hearing public, and these distributors also serve as the best market for parts and accessories.

There is substantial evidence to sustain the findings below that there are only approximately 1000 established responsible distributors specializing in the sale of hearing aids in the United States and, of these, 220 are [208] distributors of the "Acousticon", operating generally under "franchises" from petitioner for designated territories and always pursuant to the terms of the restrictive, exclusive-dealing agreements which, together with the arrangements which commonly accompany them, forbid dealing in the products of competitors and in the sale or distribution of used instruments which are traded in or may be otherwise procured or obtained; and the strict enforcement of such agreements has had the effect of establishing and maintaining an area or segment of the hearing aid business in which the independent distributors of the "Acousticon" will not undertake to sell the hearing aids of competing manufacturers but deal only in the "Acousticon", despite requests by competing manufacturers that they handle their products, and despite the fact that many independent distributors handle more than one make of hearing aid. Accordingly, it was found by the hearing examiner and by the Commission:

> "Respondent's distributors constitute a substantial segment of the outlets for sale of hearing aids and supply coverage for the more important trade areas of the United States. In such segment the respondent has effectively established a monopoly. Competing manufacturers of hearing aids have suffered substantial injury in the form of loss of sales and inadequate distribution of their competing products as a result of the respondent's requirements that

> its distributors and dealers handle only the products manufactured and sold by the respondent, and such competing manufacturers have been forced to sell less desirable outlets for their products such as optical stores, department stores and drug stores."

There are various terms of the agreements which serve to implement the exclusive-dealing features, the most important of which is the following restrictive covenant, which applies in case the agreement be cancelled by either party, as would doubtless be the result of any persistent attempt by the distributor to sell the hearing aids of competitors [209]:

> "21. In the event of the termination of this agreement by either party, Distributor expressly covenants and agrees that for a period of one year from the date of said termination Distributor will not, directly or indirectly, carry on, or be engaged, employed or interested in any hearing aid business within the territory outlined in Paragraph '2' hereof, either alone or jointly with, or as agent or employee of, any person, firm or corporation, and that during said one year period, within the aforesaid territory Distributor will not, in any manner whatever, solicit or accept the custom, trade, or business of any user of or prospect for hearing aids. Distributor further covenants and agrees not to do any other act that shall or may prejudice the business of the Company or any other Distributor of the Company within the territory outlined in Paragraph '2' hereof."

These findings are supported by substantial evidence and we see no occasion to review the evidence in detail.

It is claimed that, as matter of law, the proofs fall short of the basic requirement of Section 3 that the effect of the

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use of these restrictive, exclusive-dealing agreements, "may be to substantially lessen competition or tend to create a monopoly". It is asserted that "competition in the industry has in fact increased" and this assertion is based upon the fact that from less than twenty in the years 1938 to 1940 the number of manufacturers of hearing aids has increased to over eighty, that competition at all times was and is keen and active, that newcomers to the industry have been able to establish themselves and increase the sale of their products from year to year and that "there is plenty of business for everyone". But the fact remains that petitioner has maintained its position, during all this period of growth of the industry, as one of the top three in the business and at least two other leading manufacturers maintain effective control [210] of a substantial number of established distributors by means of similar restrictive, exclusive-dealing agreements.

Thus, it is apparent that the first question presented for our resolution relates to the necessary evidence required to bring this case within the qualification to the otherwise general proscriptive language of Section 3 of the Clayton Act. Specifically, we are required to decide whether the phrase "may be to substantially lessen competition or tend to create a monopoly" precludes a finding of unlawful conduct under Section 3, in the absence of a showing that as a result of the use of these exclusive-dealing arrangements there has, in fact been or probably will be a diminution in competitive activity, or in the face of evidence tending to indicate that the number of competitors in a particular line of commerce has increased.

Closely related to this question of the sufficiency of the government's evidence to establish a violation of Section 3 of the Clayton Act is the problem of what proof, if any, may be introduced to refute the inferences to be drawn from the proof of the employment of these restrictive devices by the petitioner or to establish a justification for their use. It is to this latter problem that the other main

contention of petitioner principally relates. Specifically, petitioner has gone to great pains to trace the development and improvement of its product, emphasizing the large expense over the years for research and engineering, demonstrating its solicitude for the hard of hearing and its efforts to use the most effective psychological and "philosophical" approach to those who hate the very thought of wearing a hearing aid, and for the employment of the most up-to-date apparatus and techniques to determine precisely the needs of each [211] individual prospective customer. As a result of these unceasing efforts to improve its product and the training programs which it has furnished to the independent retailers with whom it deals, petitioner asserts that it has an established good will and a reputation for the excellence of its product and that these exclusive-dealing contracts are indispensable to the maintenance of its status and are necessary to prevent the almost certain diminution in the quality of its service to the public which would occur if its distributors were permitted to sell other makes of hearing aids in addition to Acousticon. Petitioner thus offers a two-pronged justification for its use of exclusive-dealing arrangements, one cast in terms of economic necessity and the other in terms of the public interest.

The opinion of the Supreme Court in *Standard Oil Co. v. United States,* 337 U. S. 293 (1949), appears in large measure to be dispositive of the first of these issues and offers much assistance in the resolution of the second. In that case, suit was brought to enjoin the Standard Oil Company of California and its wholly owned subsidiary, Standard Stations, Inc., from enforcing or entering into exclusive supply contracts with independent dealers in petroleum products and automobile accessories. In an effort to establish that these practices were violative of Section 1 of the Sherman Act and Section 3 of the Clayton Act, evidence was introduced showing: that the Standard Oil Company of California through its own service stations, sold petro-

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leum products to independent service stations and to industrial users in Arizona, California, Idaho, Nevada, Oregon, Utah and Washington; that it was the largest seller of gasoline in the area, its total sales amounting to 23% of the total taxable gallonage sold there; that [212] 6.7% of the total taxable gallonage sold in the area was sold by Standard to independent service stations under exclusive-dealing contracts; that the dealers with whom Standard had these contracts comprised 16% of the retail gasoline outlets in the area; and that Standard's major competitors employ similar exclusive dealing arrangements. In affirming the District Court's decree granting the injunction, its exclusion of testimony concerning the economic merits of the system used as contrasted to other possible systems and its determination that it was unnecessary to make findings concerning the comparative economic status of Standard and its competitors before and after the adoption of that system, the Supreme Court addressed itself to the proscriptive effect of Section 3 of the Clayton Act and found it necessary to construe the very same qualifying phrase with which we are now concerned.

After reviewing its previous decisions which had indicated that proof of the use of exclusive-dealing agreements by a dominant power in an industry was all that was necessary to establish a violation of Section 3 of the Clayton Act and the extension of that doctrine in the case of contracts tying the sale of non-patented to patented products to situations where it is shown merely that the volume of business affected was not insubstantial and that competitors were preempted from a substantial market [1], the Court concluded that "the qualifying clause of Section 3 is satisfied by proof that competition has been foreclosed in a substantial share of the line of commerce affected".

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[1] *International Salt Co.* v. *United States*, 332 U. S. 392 (1947);

Cf. Signode Steel Strapping Co. v. *Federal Trade Commission*, 132 F. 2d 48, 53-54 (C. C. A. 4, 1942). [213]

This disposed of an assertion virtually identical with the first contention of the petitioner in the instant case. The Court stated (pp. 311, 314):

> "We are dealing here with a particular form of agreement specified by Section 3 and not with different arrangements, by way of integration or otherwise, that may tend to lessen competition. To interpret that section as requiring proof that competition has actually diminished would make its very explicitness a means of conferring immunity upon the practices which it singles out. Congress has authoritatively determined that those practices are detrimental where their effect may be to lessen competition.
>
> * * *
>
> It cannot be gainsaid that observance by a dealer of his requirements contract with Standard does effectively foreclose whatever opportunity there might be for competing suppliers to attract his patronage, and it is clear that the affected proportion of retail sales of petroleum products is substantial. In view of the widespread adoption of such contracts by Standards competitors and the availability of alternative ways of obtaining an assured market, evidence that competitive activity has not actually declined is inconclusive. Standard's use of the contract creates just such a potential clog on competition as it was the purpose of Section 3 to remove wherever, were it to become actual, it would impede a substantial amount of competitive activity."

Thus it appears clear that unless the petitioner's second contention seeking to justify the employment of these exclusive dealing arrangements upon economic grounds or because their use is in the public interest, is sustained, the proof adduced herein, indicating that the petitioner has

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been doing business amounting to $2,000,000 a year and has, through these contracts, foreclosed competitors from dealing with more than 22% of the nation's choicest retail outlets for hearing aids, would seem not only to support but virtually to compel a finding that Section 3 has been violated.

Preliminarily, it should be noted that potential or even probable adverse effects upon petitioner's business alone is not a sufficient basis for withholding injunctive relief. Were we to hold otherwise, we would quite effectually draw the teeth of Section 3 and of the anti-trust laws generally. [214] It appears self evident that any prohibition upon behavior which stifles competition will necessarily enure to the immediate economic disadvantage of the individual or business organization engaging in that behavior. The more efficacious these clauses are in the maintenance of petitioner's competitive position, the clearer is the case against permitting their continued use. We are thus constrained to conclude that it is only when the factors relating to economic necessity and public interest take the case outside the scope of the purpose for which the particular prohibition was imposed that they become relevant. Whether organizations situated as is the petitioner can ever successfully avail themselves of any opportunity to introduce evidence of economic data to remove themselves from the proscriptive effect of Section 3 is a question which underlies both of petitioner's main contentions. On the one hand, petitioner sought to accomplish this by demonstrating that competition had not diminished because of the use of these devices and on the other, by asserting that the purpose of their use was not to suppress competition but to attain legitimate economic ends. Assuming the appropriateness of allegations of this nature in a suit brought under the Sherman Act, we still must examine the extent of their efficacy under Section 3 of the Clayton Act.

There is little doubt that Congress, in passing the Clayton Act, sought to bring within the scope of its proscriptive

provisions, conduct and practices which, though dangerous to the competitive structure, were not covered at all or only inadequately covered by the provisions of the Sherman Act. Senate Rep. No. 698, P. 1, 63rd Cong. 2d Sess. (1914); H. R. Rep. No. 627, P. 13, 63rd Cong. 2d Sess. (1914). Thus in connection with the [215] specific practices condemned by the later Act, the standards of legality previously applied were rejected and new criteria substituted therefor. *Standard Fashion Co.* v. *Magrane-Houston Co.*, 258 U. S. 346, 356 (1922).

With respect to exclusive-dealing contracts, the evident impulsion toward including a specific proscriptive provision was the desire on the part of the Congress to overrule by legislation an earlier decision of the Circuit Court of Appeals in *Whitwell* v. *Continental Tobacco Co.*, 125 F. 454 (CCA 8, 1903), upholding, as not violative of the Sherman Act, what was tantamount to the refusal, by a leading producer of chewing tobacco, to sell to a dealer because the dealer would not agree to deal exclusively in the seller's products (51 Cong. Rec. 16318 (1914)). It was to make sure that the Sherman Act "rule of reason" would not be employed to validate further transactions of such a patently undesirable nature that the proscriptive provision under discussion was thought necessary. It is hardly likely that the insertion of the qualifying phrase, "where the effect * * * may be to substantially lessen competition or tend to create a monopoly," was intended to reinstate the same Sherman Act tests which had, at that very time, been determined to be inadequate.

Moreover, the history of the inclusion of the qualifying phrase in no way supports the view that it was designed to effect a renaissance of the Sherman Act type of inquiry into all economic factors, in every Clayton Act suit to enjoin the use of an exclusive-dealing contract.

At the time of its initial approval by the House of Representatives, that portion of the Clayton Bill relating to exclusive-dealing contracts contained an unqualified pro-

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scription of agreements of such a nature. See Section 4 of the Clayton Bill in H. R. Rep. No. 627, P. 2, 63rd Cong. 2d Sess. (1914). However, the Senate Judiciary Committee, apparently in the belief that [216] the Federal Trade Commission Bill then pending would adequately cover this matter, struck the section entirely. Upon a reconsideration of the Committee's action on the floor of the Senate, issue was taken with the unqualified nature of the House version only in so far as it declared these contracts unlawful even when engaged in by newcomers or small business enterprises in a particular line of commerce who, perhaps, could effectively compete with established interests only if these devices were available to them. 51 Cong. Rec. 14094 (1914). It may be inferred, therefore, that the Conference Committee's compromise provision, which included this qualification in the exclusive-dealing contract section for the first time, was designed to accomplish no more than the protection of the "newcomer" or "small" business organization.

In so doing, it is hard to believe that the Congress envisioned a full dress inquiry into economic motives or effects of such contracts in all cases, including those involving the use of these devices by established leaders or prominent businesses in an industry. Certainly such a view is more in consonance with the evident congressional purpose in passing the Clayton Act than is a view which could conceivably obliterate any distinction between the test applicable here and the tests previously applied.

The cases in which the Supreme Court has dealt with the problem of exclusive-dealing arrangements evince a recognition of the legislative intention outlined above. Where the alleged violator dominated or was a leader in the industry, proof of such fact was, at an early stage, determined to be a sufficient predicate from which to conclude that the use of exclusive-dealing contracts was violative of Section 3 and other factors appear to have been

largely ignored. *Standard Fashion Co.* v. *Magrane-Houston Co., supra; Fashion Originator's Guild* v. *Federal Trade Commission*, 312 U. S. 457 [217] (1941); cf. *United Shoe Machinery Corp.* v. *United States*, 258 U. S. 451 (1922); *International Business Machines Corp.* v. *United States*, 298 U. S. 131 (1936). More recently, the Supreme Court extended the rule to business organizations enjoying a powerful, though clearly not dominant, position in the trade and doing a substantial share of the industry's business by means of these contractual provisions and tacitly approved the trial court's refusal to consider other economic effects or merits of the system employed. *Standard Oil Co.* v. *United States, supra.* In so doing, great reliance was placed upon the congressional purpose to supplement earlier anti-trust laws by the passage of Section 3. The Court stated:

> "It seems hardly likely that, having with one hand set up an express prohibition against a practice thought to be beyond the reach of the Sherman Act, Congress meant, with the other hand, to reestablish the necessity of meeting the same tests of detriment to the public interest as that Act had been interpreted as requiring. * * * To insist upon such an investigation would be to stultify the force of Congress' declaration that requirements contracts are to be prohibited wherever their effect 'may be' to substantially lessen competition" (pp. 312-13).

Only two Supreme Court cases remain for further consideration. The first, *Federal Trade Commission* v. *Sinclair Refining Co.*, 261 U. S. 463 (1923), referred to in the *Standard Oil* case as supporting the company's position, actually held nothing more than that the Clayton Act was inapplicable because the contracts were not exclusive-dealing agreements within the provisions of Section 3. The economic inquiry involved related to alleged violations of

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the unfair competition proscription of Section 5 of the Federal Trade Commission Act. In determining whether these practices constituted unfair competition, the declared inapplicability of the Clayton Act required that the court revert to the Sherman Act which, in turn, required the economic analysis in which the court indulged. [218]

The Supreme Court's per curiam affirmance of the Circuit Court's consideration of economic motives and effects of the exclusive-dealing contracts in *Pick Mfg. Co.* v. *General Motors Corporation,* 80 F. 2d 641 (CCA 7, 1935), affirmed 299 U. S. 3 (1936), is more troublesome. The erroneous description, in the opinion of the Circuit Court of Appeals, of the Clayton Act qualification as requiring that "the effect of the agreement will be to lessen competition substantially", rather than the actual statutory test requiring that the effect "may be" to substantially lessen competition, conjoined with its misplaced reliance on the *Sinclair* case, may account for its indulgence in a Sherman Act type of inquiry. In view of the Supreme Court's per curiam affirmance, however, we must conclude that the reasoning of the Circuit Court of Appeals in the *Pick* case was not approved, and, in any event, such reasoning is quite at variance with that of the Supreme Court in *Standard Oil Co.* v. *United States, supra.*

In light of the foregoing, it seems clear that whatever utility the elaborate economic inquiry contended for by petitioner may still have under Section 3 of the Clayton Act when applied to organizations not doing a substantial share of the business or not yet firmly established in a particular line of commerce, it has no place in a case such as this where the condemned contracts are being employed by a corporation which does almost $2,000,000 worth of business each year, is one of the industry's three leaders, all or some of whom use this restrictive device, and which alone controls by such means over one-fifth of the nation's prime retail outlets for products of this kind. Accordingly,

we need not weigh the claims of petitioner that its Acousticon hearing aid is the best in the market; it may be assumed that it has marked superiority over some of the many others available. We are not [219] concerned with the merits of petitioner's product but only with the probable effect on competition of the use of these restrictive, exclusive-dealing covenants. It is the policy of the Congress that this merchandise must stand on its own feet in the open market, with whatever benefits may be derived from the use by petitioner of its own methods both psychological, "philosophical" or otherwise, but without the competitive advantage to be obtained by the use of the prohibited exclusionary agreements. Under this view of the proscriptive effect of Section 3, it is immaterial that most of the dealers with whom these contracts were entered into were brought into the hearing aid business by the petitioner.

The furnishing to petitioner's distributors of names and addresses of users of the Acousticon hearing aid in their territories, together with additional names and addresses of prospects obtained through the use of various advertising media, and the pamphlets, mechanical testing apparatus and other material, would seem to be the legitimate property of petitioner. Nothing in the cease and desist order now before us for review would seem to prevent petitioner from protecting itself against the use of such data and material in the sale of the products of competitors.

It may well be that, after the removal of the prohibited clauses, many if not most of petitioner's distributors will voluntarily prefer to deal exclusively with the "Acousticon" hearing aid and its parts and accessories. If it possesses the virtues extolled by the petitioner's witnesses, there would seem to be sound business reasons for believing that this will be so. But if others, whose clientele may not be composed of so many people of means, desire to take on the products of other manufacturers which command a [220] lower price, even if not of so superior a

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quality in appearance or performance, and also to sell used instruments which have been traded in or otherwise obtained, the result will be the very result intended by the framers of the statute.

We entertain no doubt that the main features of the determination made by respondent herein are in the public interest. The philosophy of the anti-trust laws in this regard were summed up in *Standard Oil Co.* v. *United States, supra,* by the statement that (p. 309):

> "But Standard was a major competitor when the present system was adopted, and it is possible that its position would have deteriorated but for the adoption of that system. When it is remembered that all the other major suppliers have also been using requirements contracts, and when it is noted that the relative share of the business which fell to each has remained about the same during the period of their use, it would not be farfetched to infer that their effect has been to enable the established suppliers individually to maintain their own standing and at the same time collectively, even though not collusively, to prevent a late arrival from wresting away more than an insignificant portion of the market. If, indeed, this were a result of the system, it would seem unimportant that a short-run by-product of stability may have been greater efficiency and lower costs, for it is the theory of the antitrust laws that the long-run advantage of the community depends upon the removal of restraints upon competition."

We find it unnecessary to discuss the remaining miscellany of minor contentions advanced by petitioner.

Affirmed. [221]

Opinion of Commission

UNITED STATES OF AMERICA

BEFORE FEDERAL TRADE COMMISSION

COMMISSIONERS:

EDWARD F. HOWREY, Chairman,
LOWELL B. MASON,
JAMES M. MEAD,
STEPHEN J. SPINGARN,
ALBERT A. CARRETTA.

Docket No. 5655

In the Matter of

DICTOGRAPH PRODUCTS, INC., a corporation.

By CARRETTA, Commissioner:

This matter involves the practice of the Dictograph Products, Inc., respondent herein, of entering into and enforcing exclusive dealing agreement with its purchasers. This company, one of the three largest in the hearing aid industry in volume of sales, sells its products to independently owned and operated distributors located throughout the United States. Since 1937 the forms of contract entered into by respondent with its distributors have contained a provision to the effect that the distributor shall not sell hearing instruments other than those manufactured by respondent. The hearing examiner in his initial decision held that the use of these exclusive dealing provisions is in vio-

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lation of Section 3 of the Clayton Act and that respondent's practice of entering into and enforcing them is in violation of Section 5 of the Federal Trade Commission Act.

Respondent in its appeal does deny that its practice is to require exclusive dealing contracts from its distributors. It contends rather that its exclusive dealing contracts are legal and proper in all respects, that they are essential to its business and beneficial to the public and that they do not have the adverse effect on competition required to make their use a violation of law. Respondent also takes exception to certain findings of fact and to the conclusions in the initial decision and, in addition, contends that certain procedural rulings of the hearing examiner were in error and seriously prejudiced its defense in this proceeding.

Respondent contends that it takes an entirely different and superior approach to the problem of assisting persons who are hard of hearing than do other sellers of hearing aids. It is of the opinion that the great majority of hard of hearing cases are not helped by an instrument which just amplifies sound but require one which amplifies a particular range of sound frequencies more than it does others. Respondent, therefore, manufactures and sells at least ten different types of receivers, each of which is designed to emphasize a different range of frequencies. It has developed special tests to determine the needs of each customer and has instructed its distributors in conducting these tests and in selecting the proper type of its instruments for use in each case. Respondent claims that many other brands of hearing aids do not follow this principle or do not offer as wide a range of types. It, therefore, contends that to permit its distributors to sell other brands which require different, conflicting and erroneous tests and sales

approach, would destroy its efforts to properly present its hearing aids to the purchasing public to its injury and to the injury of the public.

This contention is believed to be of no merit. It is recognized that it may be an advantage to a seller to have the distributors of his products concentrate their sales efforts on his products only. This may be particularly true where the seller has developed a sales approach and technique which conflicts with the sales approach required to sell competitive products. However, exclusive dealing agreements between independent distributors and a seller are expressly prohibited by Section 3 of the Clayton Act where the requisite effect on competition is present. The economic advantage to respondent of requiring its distributors to contractually agree not to sell competing products will not justify a violation of this section of the Act. The purpose of this Act is to preserve competitive conditions. Congress by passing this Act has determined that the public interest requires that the advantage of requiring its distributors to agree to deal exclusively in its products must be denied a seller where the effect of such agreements may be to substantially lessen competition or to tend to create a monopoly.

In support of its contention that its exclusive dealing agreements have not had the requisite effect on competition, respondent urges that competition in the industry has in fact increased, that respondent did not take over existing distributors but established its own and that its distributors do not have a monopoly of the hearing aid market in any city or area of the country.

The record shows that respondent sells its hearing aids to approximately 220 well-established distributors who specialize in the hearing aid field. These distributors are retailers who sell directly to the public. These distributors,

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each of which has entered into an exclusive dealing agreement with respondent, comprise a substantial portion of the established responsible distributors specializing in the sale of hearing aids in the United States. One informed estimate in the record is that there are only approximately 1,000 such accounts in the United States. These accounts which specialize in the sale of hearing aids constitute the best market for these products. The nature of this market is such that to sell effectively potential users of hearing aids must be sought out and convinced of the advantages of hearing aids to them. Many persons who are hard of hearing are reluctant to wear hearing aids and will not shop for this product. Well-established distributor accounts specializing in the sale of hearing aids employ a field sales force and concentrate their sales efforts on locating and selling such potential users. In this manner a market is reached which is not accessible to accounts selling across the counter only. Also, well-established distributor accounts build up a satisfied clientele which constitutes an excellent market for the sale of improved models. Thus, effective control of a substantial number of these established distributors is of great advantage to a manufacturer of hearing aids.

During the last fifteen years, due to great technical advances in the product, there has been a tremendous growth in the hearing aid industry. Sales have boomed. The number of producing companies in the field has increased from twenty to over eighty. Respondent, which has used its exclusive dealing contracts throughout this period, has maintained its position as one of the top three in the industry.

During this period of expansion, hearing aid manufacturers trying to break into this field found that they

were foreclosed from selling to respondent's distributors by the exclusive dealing requirement in respondent's contract with its distributors. These newcomers in the field were forced to turn to other nonexclusive distributors and to less desirable outlets, such as optical, drug and department stores. Certain of them, notably Zenith Radio Corporation, which is now first in volume of sales in the industry, were able to successfully enter this field despite this handicap. They are now in the process of locating and establishing other independently owned purchasers for their products who will specialize in the sale of hearing aids.

Respondent's exclusive dealing contracts contain provisions authorizing termination at any time by either party. However, they also provide that after termination by either party the distributor will not engage in the hearing aid business in the same sales area for a period of one year. Thus, under the terms of this contract the distributor agrees to go out of the hearing aid business for one year if he becomes unwilling to continue to sell respondent's hearing aids exclusively. Respondent's policy has been to require compliance with the exclusive dealing requirement and to threaten cancellation of the distributorship for selling competing products. Respondent in several instances has cancelled distributorships for violation of the exclusive dealing requirement and has brought legal proceedings seeking enforcement of the termination provisions. As a result respondent has restricted its independently owned distributors in their choice of products and has to a great extent foreclosed to its competitors access to the customers served by its distributors.

By the Clayton Act, Congress designated exclusive dealing contracts as unreasonable restraint on trade where their effect may be to substantially lessen competition. That test is met here where one of the largest producers

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in the field has tied up a substantial portion of the established retail outlets with exclusive dealing contracts containing such termination provisions, and where the contracts not only tend to foreclose a substantial portion of the market to respondent's competitors, but also deny competitive opportunities to respondent's distributors. Under such agreements the distributors must refuse all opportunities to sell competing brands, including those desired by their customers. They are also denied any opportunity to handle superior or better priced products which may come on the market. Such contracts affect a substantial volume of business and tend to substantially lessen competition in violation of Section 3 of the Clayton Act. It is believed, therefore, that respondent's contention that the record does not establish a violation of the Clayton Act is of no merit and should be rejected.

Similarly, it is believed that the hearing examiner correctly held in his initial decision that respondent's practices of entering into contracts containing exclusive dealing provisions with its distributors and of intimidating and coercing them into complying with these provisions were unfair methods of competition and unfair acts and practices in commerce in violation of Section 5 of the Federal Trade Commission Act.

Also, respondent's coercive practices, in addition to being unfairly used to enforce an illegal exclusive dealing arrangement, constitute unfair restrictions on respondent's distributors in the operation of their independently owned businesses. Respondent's contracts with its distributors, by not providing any means by which a distributor can withdraw from the arrangement without bringing into effect his agreement to go out of the hearing aid business completely for one year in that sales area upon termination of the agreement, and by permitting respondent to cancel any distributorship without cause and thus bring

this termination provision ito effect, have provided respondent with the means of coercing and intimidating its distributors into operating their businesses in accordance with respondent's dictates. Respondent has used these means to exert pressure on distributors who were selling used hearing aids and on others who were considering taking on other lines of hearing aids in place of respondent's products. The use by respondent of these means to coerce and intimidate its distributors in this manner constitutes an unfair act and practice and an unfair method of competition within the meaning of Section 5 of the Federal Trade Commission Act.

Respondent has specifically excepted to certain of the findings of fact and to the conclusions set out in the initial decision. These exceptions are believed to be of no merit for the following reasons:

Respondent contends that there is no record basis for the finding that its method of distribution is generally followed by competitors. Respondent misinterprets this finding which does not hold that competitors follow respondent's practices to the extent of assigning exclusive territories, furnishing confidential lists of prospects and encouraging their distributors to operate under names incorporating their trade names. The excepted to finding only states that respondent's method of selling to independently owned distributors is followed generally by most competing manufacturers. Certain competitors sell through optical, drug and department stores. However, the record indicates that established distributors specializing in this field are very desirable accounts and that most manufacturers in this field attempt, with varying degrees of success, to sell to such accounts.

The record contains an estimate by Mr. Charles Lehman, who has been very active in this field for over thirty years,

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that there are approximately 1,000 responsible dealers specializing in the sale of hearing aids in the United States. This estimate excluded accounts selling other products and subdealer accounts. These are the approximately 1,000 distributor accounts referred to in the finding excepted to by respondent. This estimate is not in conflict with the testimony of representatives of respondent's competitors stating the number of their sales outlets, as the record does not show how many of those outlets, so referred to, can properly be defined as responsible distributors, specializing in the sale of hearing aids only. It is clear from the record that certain of those accounts do not fit into this category.

The record clearly supports the finding that respondent required its distributors to refrain from selling used hearing aids. It shows that respondent gives its distributors a trade-in allowance and requires all used hearing aids to be turned in to it. This requirement was included in the distributor agreements until 1945. The practice was abandoned for a short period in 1945 but was soon resumed, being placed in effect by oral directions to the distributors from respondent's sales representatives. Respondent's exception to this finding, therefore, is of no merit.

Respondent contends that its distributors voluntarily agreed to deal exclusively in its products in return for other considerations and that its desire to enforce these agreements is improperly found to be coercion and intimidation. The record shows that when respondent finds that one of its distributors is selling competing products, it threatens to terminate the distributorship and calls attention to the provision of the agreement requiring the distributor to withdraw from the hearing aid field in that sales area for one year, in an attempt to intimidate and coerce the distributor into continuing to sell its products on an exclusive basis. Respondent's exception to the find-

ing of coercion and intimidation, therefore, is believed to be of no merit.

The contention that the findings erroneously state that respondent's hearing aids are adaptable only to various degrees of hearing losses is of no merit. The findings, in effect, further state that respondent's line of instruments provides a broad variety of frequency responses, as contended by respondent.

Respondent's exception to Paragraphs Thirteen, Fourteen, and Fifteen of the findings as to the facts and to the conclusions set out in the initial decision as not being supported by the evidence of record is rejected by the Commission.

Respondent's contention that the hearing examiner committed prejudicial error by certain of his procedural rulings is also rejected. His refusal to compel counsel supporting the complaint to furnish respondent with a list of witnesses prior to the hearings does not constitute a violation of due process as full opportunity to cross-examine each witness called was available to it. If later investigation had revealed the existence of documents or other material which would have enabled respondent to impeach or otherwise materially affect previously given testimony, that witness could have been recalled for further cross-examination on respondent's motion.

The hearing examiner acted within his discretion in refusing to compel Commission's witness Whitcomb to turn over to respondent's counsel a file of his papers which he had with him in the hearing room. This witness made no reference to these papers on direct examination and only referred to them on cross-examination when pressed to give exact dates upon insistence of counsel for respondent. There is no indication that any of these papers contain anything in conflict with the witness's testimony. It is

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well settled that where a witness is testifying from his recollection and not upon the basis of documents, the opposing party has no absolute right to inspect documents in his possession for exploratory purposes. Similarly the hearing examiner was acting well within his discretion in refusing to direct witness Ranson to produce written communications between himself and attorney for the Commission and in refusing to direct counsel supporting the complaint to produce a written statement of witness Englis made during the preliminary investigation of this matter. These documents were not used by the witness in testifying and there is no indication that they contain anything in conflict with the witnesses' testimony. The hearing examiner also properly refused to compel witness Ranson to produce from his office copies of his contracts with competing companies, it not having been shown that these documents are relevant in any manner to this proceeding.

The hearing examiner's ruling refusing to admit certain documents into evidence which are specifically excepted to by respondent are sustained by the Commission. Respondent's Exhibits 90 through 92 for identification, which consist of a Sears, Roebuck and Company advertisement and pages from its catalogs, have not been shown to be material in any respect. The other proposed exhibits, the rejection of which is specifically excepted to, consist of documents relating to the nature of a Public Health Survey which purportedly recommended a new approach to helping persons who are hard of hearing, documents indicating the superiority of this new approach and documents showing respondent's adoption of this approach in its business and its efforts in developing instruments and procedures for use in carrying out the recommended program in its business. These documents were properly rejected as being immaterial to the issues herein. Other valid

reasons for rejecting these documents were given by the hearing examiner in his rulings which specifically apply to the individual offers.

The Commission, therefore, is of the opinion that respondent's appeal from the initial decision of the hearing examiner is of no merit and should be denied.

Chairman Howrey and Commissioner Mason are of the opinion that since the order to cease and desist contained in the initial decision is sustained by the Commission's interpretation of Section 3 of the Clayton Act as applied to the facts of this case, it was not necessary to go on to consider whether it might also be sustained by Section 5 of the Federal Trade Commission Act. See *Standard Oil Co. of California* v. *U. S.*, 337 U. S. 293, 314.

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